FEATURE

A top-down look at 'junk'

By Martin S. Fridson

With high-yield, or junk bond, debt representing 20% of the total corporate bond market, it is an asset category that is difficult to ignore, but costly to examine.

The necessary research and specific credit analyses preclude many institutions with limited management resources from investing in the debt. Investors continue to wonder whether top-down management skills they have developed in other markets can be transferred to the speculative-grade (i.e., below triple B) segment.

They see their market-timing talents of limited value, because low-rated bonds do not respond as directly as high-grade bonds to interest rate movements.

Their top-down approaches of identifying undervalued sectors of the market appear of little use if, as they might have been told, each high-yield issue trades on the basis of its unique credit characteristics, with no observable industry group effect. They believe active management strategies of the top-down sort are not productive in an environment where, they suppose, secondary market-making is sparse and dominated by a single firm.

These are proper concerns for the pension fiduciary investigating unfamiliar territory. To some extent, however, the questions reflect a lag in recognition of important changes that are making the high-yield bond sector more similar to other securities markets.

In the past few years, primary market share has been dispersed rapidly among several leading underwriters. While the perception persists among non-participants that the high-yield secondary market is monopolistic, portfolio managers familiar with the sector know that to get bigger pieces of the underwriting pie, competitors have had to expand their market-making activities as well.

This in not to deny that for many smaller issues the underwriter is the only firm providing research coverage or making a market. Such bonds represent a subsector of the high-yield market in which investment organizations lacking large in-house credit staffs may indeed be ill-equipped to operate.

There is another subsector, however, for which many pension investors are well suited. It is the so-called go-gos. These are large, liquid issues — in many cases created through recapitalizations of major companies formerly rated A or double A — and are well-adapted to the total-return style.

With perhaps six securities firms analyzing and making markets in go-gos, issues by such companies as Beatrice Cos. Inc., FMC Corp., R.H. Macy & Co. and Owens-Illinois Inc. typically trade with bid/asked spreads of about $5 per $1,000 face value. Such a spread typically is good for trades of par amounts up to $5 million, indicating the amount of liquidity available to investors without disrupting the market and influencing the bond's price.

Using this select group of go-gos, pension investors can implement top-down management strategies that resemble their approaches to other sectors and produce attractive returns at acceptable risk.

For example, an especially conservative pension fund might not be willing to allocate even a portion of its assets to a pure high-yield program, but might approve a hybrid strategy, combining high-yield bonds and Treasury securities. The proportions of the two asset classes within the hybrid portfolio can be varied, depending on market conditions and relative value. This is an active approach that will lend itself well to skills that are highly developed within many pension fund organizations.

There is sufficient volatility in the spread between high-yield bonds and 10-year Treasuries to make this hybrid strategy worthwhile. (The average maturity of junk bonds at the end of 1987 was about 10½ years.)

Between January 1986 and the end of last month, for example, the spread ranged between about 360 and 570 basis points.

Total return figures tell the same story. During 1987, high-yield bonds outperformed intermediate Treasuries through the first nine months, but were swamped (7.52% vs. 1.02% non-annualized) in the fourth quarter.

To quantify the benefits of market timing, imagine a hybrid portfolio with a maximum high-yield weighting of 50% and a minimum of 0%, with the balance invested in intermediate Treasuries.

A manager who read the market conditions correctly would have been at a maximum high yield position through Sept. 30 and fully invested in Treasuries for the balance of the year.

Allowing one full point of transaction costs on the switch, the hybrid portfolio would have returned 4.57% for the year, a significant improvement over the full-year −1.81% return provided by a pure intermediate Treasuries portfolio.

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Martin S. Fridson, principal and manager of credit research at Morgan Stanley & Co., New York, adapted this article from a report he wrote.

BellSouth

Junk bond total returns
(by industry sector)

	1987	1988
Consumer goods	5.3 %	16.72%
Conglomerates	−0.04	10.59
Electric utilities	0.48	22.58
Energy	9.46	0.24
Financial services	2.69	19.03
Gas utilities	11.25	12.48
Health care	−3.08	15.66
Leisure products	−0.72	16.56
Building products	4.34	18.11
Capital goods	5.78	14.49
Chemicals	3.7	20.7
Packaging	5.31	15.75
Manufacturing	−1.63	18.58
Media	10.57	21.15
Metals/mining	15.08	−11.93
Real estate/const.	−4.12	16.97
Retailing	3.22	12.63
Technology	−2.09	15.66
Telecommunications	10.54	−4.81
Transportation	0.13	8.41

Source: Morgan Stanley & Co., New York

Junk market

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The hybrid strategy also would have reduced volatility — instead of a −6.31% loss in the third quarter on Treasuries, an investor would have lost only −3.84% with a 50/50 mix.

Another top-down technique that can be adapted from other segments of the capital markets involves swapping between industry subsectors. Today's high-yield issuers are fairly well distributed among a variety of industries, in contrast to conditions that prevailed five to 10 years ago. In 1987, the market totaled about $130 billion par value. These industry subsectors can display widely divergent returns, reflecting differing short-term and long-term credit trends, as shown in the chart.

Capitalizing on this variability of returns requires the use of a larger universe than just the go-go issues, and therefore a larger commitment of resources to individual-company credit analysis. If the resources are available, however, there can be a substantial payoff on correctly predicting the industry winners and losers.

Based on the 1987 range of total returns (from 15.08% in metals/mining to −4.12% in real estate/construction), let us suppose a manager had simply identified the industries that constituted the worst-performing quartile.

An equally weighted portfolio of the remaining 15 industries would have produced a return of 5.85%, vs. 3.81% for the passive 20-industry portfolio. (Because some high-yield issues are not classified among the industries Morgan Stanley & Co. tracks, the 20-industry return varies somewhat from the total return of 4.61% that we estimate for the entire high-yield universe in 1987.)

Correctly selecting the top half of the industry universe would have raised the portfolio's return to 8.13%, while concentrating on the top quartile would have earned 11.38%.

These results suggest a manager who is oriented toward spotting group trends need not be intimidated by the prospect of participating in a market in which bottom-up security selection has heretofore been the dominant style of management.

It is true that each year, painstaking credit work on individual issuers turns up a limited number of opportunities to realize 10% and 20% gains. The overall portfolio impact of these "home runs" might be limited, however, by single-issuer concentration restrictions — typically 5% of assets for high-yield mutual funds. ■

Trends

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the firm in a search.

He complained about "the inability of (some) managers to admit mistakes." He told a story about an unidentified investment manager with a big commitment to the energy sector, which began to turn around only after seven years of languishing. At risk of sounding as if he were endorsing emphasis on short-term results, Mr. Lincoln said he "found seven years beyond the pale of human tolerance."

In addition, he said he looks askance at "a manager that tries to change the name of his style to fit what's in vogue," or those that pick unique time periods, or inappropriate benchmarks, to report performance.

He also stressed that managers must be sensitive to clients. Without mentioning names, he told of a manager, vying for an assignment, who appeared before representatives of a union fund bragging about the quality of its computer-produced reports. The union, Mr. Lincoln noted, represented printers; it didn't even allow the manager to finish the presentation.

"We want people who can do (a presentation) well," Mr. O'Donovan added. "It takes a lot of skill. . . . We don't want any surprises."

He mentioned an unidentified manager pitching to a group of nuns for an assignment.

Without any forewarning, the manager "decided to do part of the presentation in Latin. The nuns didn't speak Latin." The manager didn't get the business.

Both Messrs. O'Donovan and O'Leary assailed the practice of some managers to use their track records at a former firm as part of the historical performance of their current firm. Mr. O'Donovan said the records were irrelevant because the investment process and contributors at each firm would be different.

Of the three consulting companies represented on the panel, Mercer-Meidinger-Hansen is the only one that doesn't accept soft-dollar payment. Mr. O'Leary noted Callan presents its clients with bills in hard dollars, "but 70% of clients elect to pay us in commission dollars."

"I'd love to see soft dollars go away," he added. "Unfortunately, I think they are going to be around for some time."

But Mr. Lincoln said "the public record of abuses of this will put pressure" for the elimination of soft dollars. "It's a question of when, not a question of if."

None of the panelists specified any abuses. ■

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Funds' focus

Continued from page 2

index fund accounts reported during the quarter.

Observers said domestic stock indexing might have reached a saturation point, while international indexing still has far to go.

Although active management attracted more business than indexing overall in both international and domestic investing, some of the largest single accounts were for index funds: the Employee Retirement System of Rhode Island and the New York-based Rockefeller Foundation each moved $150 million to equity index accounts. Because of this, prominent indexers are the top two firms in assets gained during the quarter: Bankers Trust Co. — Investment Management Group, New York, and Wells Fargo Investment Advisors, San Francisco.

Although international managers are predicting huge inflows into international fixed-income indexing accounts, none of the $117 million allocated to international bonds during the quarter was indexed. Of the $836 million allocated to domestic bonds, actively managed accounts drew $661 million; dedicated or immunized portfolios, $100 million; and index funds, $75 million.

Domestic balanced management accounted for $144.5 million; also, one $20 million global balanced account was reported. There was $96.5 million in accounts defined as "active" or "tactical" asset allocation; real estate accounts drew $609 million; venture capital, $61 million; and guaranteed investment contracts, $38 million.

Hirings by public pension funds again contributed to the big numbers in the international area.

The $7.2 billion Public Employees Retirement Association of Colorado, Denver, doubled its international commitment by hiring three active equity managers for up to $100 million each. The $1 billion New Hampshire Retirement System hired its first two global bond managers for $15 million each.

Passive international strategies might stand to gain because of active managers' difficulty in outperforming market indexes.

That was the reasoning behind the $1.8 billion Rockefeller Foundation's $150 million shift to an enhanced passive strategy, managed by Wells Fargo, from active international managers.

Interest in international investing, however, might be peaking, some consultants said. "We don't see the trend continuing much longer," said James E. Yanni, senior vice president of Butcher Consulting Group, Pittsburgh.

"There is interest, but people are a little bit concerned that the dollar may have hit bottom," added Keith Stransky, vice president of Evaluation Associates Inc., Norwalk, Conn.

Styles come in and out of favor, and active management might be coming in, Mr. Yanni said. One reason might be the recent good performance of small-capitalization stocks, as opposed to the large-cap issues in the Standard & Poor's 500 stock index, he said. During the first quarter, the NASDAQ industrials returned 13.4% vs. the S&P 500's 4.8%.

Paul Berg, president of Berg Fiduciary Consultants Inc., Port Chester, N.Y., said pension executives seem to have the greatest interest in quantitative equity strategies.

Quantitative managers that had large or multiple new accounts in the quarter included The Chicago Corp., Denver Investment Advisors and Pittsburgh-based Triangle Portfolio Associates.

In real estate, the past quarter's numbers were buoyed by an apartment fund offered by Security Capital Real Estate Corp., New York; it drew seven clients and $74.5 million. In venture capital, First Chicago Investment Advisors' $50 million pooled fund helped the firm show the largest number of new accounts, nine, reported during the quarter. ■

Most new assets*
2nd quarter 1988

Firm	$ millions
Bankers Trust	189
Wells Fargo	160
Morgan Stanley	140
Denver Investment	130
Nomura Capital	125
Oechsle International	120

* As reported in *Pensions & Investment Age*

Most new accounts*
2nd quarter 1988

Firm	New accounts
First Chicago Investment	9
Security Capital Real Estate	7
Harris Trust	5
Trust Co. of the West	5
Miller, Anderson & Sherrerd	4
J&W Seligman	4

* As reported in *Pensions & Investment Age*

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CIBA plan adds exec, advisers

By Marlene Givant

ARDSLEY, N.Y. — The $550 million CIBA-GEIGY Corp. pension fund has appointed a new pension executive, hired four fixed-income managers and might increase its allocation to venture capital and real estate.

Bob Hunkeler, formerly controller of the pharmaceutical division of the parent company, CIBA-GEIGY Ltd., Basel, Switzerland, has been named manager of trust investments.

In his new post, Mr. Hunkeler will develop recommendations for the long-term investment policy of the pension trust and evaluate the performance of managers. He will report to William J. McHugh Jr., director of trust funds, who previously held the position.

Mr. Hunkeler's first projects will include a venture capital search using Wilshire Associates, Santa Monica, Calif. The fund plans to allocate $10 million to four partnerships to get closer to a 5% venture capital target from the 2% in venture capital now.

Mr. Hunkeler also will undertake an in-house study of real estate to see if the fund should increase its allocation to 15% from 10%.

With all these asset allocation decisions in the works, the fund has shifted $70 million to intermediate-term fixed-income accounts as an alternative to cash.

Brown Brothers Harriman & Co., J.P. Morgan Investment Management Inc. and Chase Investors Management Corp., all of New York, each will manage $15 million. NCNB National Bank, Charlotte, N.C., will manage $25 million in its Stable Capital Fund. All portfolios will have maximum maturities of four years with average durations between 1.5 and 2.5 years.

The fund, which has 15% in fixed income, has a long-term target of 20% for the asset class. "This (set of hirings) was an intermediate step," Mr. McHugh said.

Assets came from accounts run by State Street Bank and Trust Co., Boston, the fund's custodian, which still runs short-term assets.

All four managers were appointed based on their success at running other CIBA-GEIGY accounts. Brown Brothers Harriman and J.P. Morgan run fixed income for the pension fund, NCNB runs real estate, and Chase runs an intermediate-term bond account for the company's 501(c)(9) plan.

The pension fund's asset mix is 45% domestic equities, 18% short-term assets, 15% fixed income, 10% real estate, 10% international and 2% venture capital. ■

CURRENT ACCOUNTS

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Schroder Capital Mgmt. Int'l
State of Connecticut Trust Funds: Pacific Basin equities; $25 million.

Scudder, Stevens & Clark
Schering-Plough Corp.: international equities; $20 million.

Security Capital Real Estate Corp.
Arlington (Va.) County Supplemental Retirement System: apartment fund; $6 million. Bank of Oklahoma: apartment fund; $1 million. Los Angeles City Fire & Police Pension System: apartment fund; $10 million. Grumman Corp.: apartment fund; $5 million. GTE Corp.: apartment fund; $15 million. Los Angeles County Employees' Retirement Association: apartment fund; $25 million. Southern New England Telephone Co.: apartment fund; $12.5 million.

Security Pacific Nat'l Bank
University of California: master custodian; $11.5 billion. Los Angeles Water & Power Employees' Retirement System: master trustee; $1.5 billion.

J & W Seligman & Co.
City of New York Fire Department Pension Fund: equities; portion of $325 million. Carteret Savings Bank: balanced; $13 million. Carteret Savings Bank: 401(k) and profit-sharing funds manager; $3.5 million. Brush Wellman Inc.: equities; $5 million.

Sovran Bank
Virginia United Methodist Homes: balanced; $1 million.

State Street Bank and Trust Co.
G.C. Murphy Co.: GICs; $18 million. Reichhold Chemicals Inc.: GICs; $10 million.

Strong/Corneliuson Capital Mgmt.
Logicon Inc.: balanced; portion of $30 million.

STW Fixed Income Mgmt.
Southern California Edison Co.: fixed income for nuclear decommissioning; portion of $100 million.

Sun Bank Investment Mgmt. Group
Oklahoma Police Pension and Retirement System: equities; $35 million.

TA Associates
Massachusetts Pension Reserves Investment Management Board: venture capital; $5 million.

TCW Asset Mgmt. Co.
National Telephone Co-op Association: real estate; $12.5 million.

TCW Realty Advisors
Cargill Inc.: closed end real estate fund; portion of $20 million. Warner-Lambert Co.: real estate; $6 million.

Trammell Crow Ventures
Michigan State Employees' Retirement Systems: real estate venture fund; $50 million. Los Angeles County Retirement Association: real estate venture fund; $10 million.

Triangle Portfolio Associates
National Telephone Co-op Association: equities; $12.5 million. Babcock Industries Inc.: equities; $10 million. International Brotherhood of Electrical Workers-National Electrical Contractors Association Pension Benefit Trust Fund: equities; $25 million.

Trust Co. of the West
Thomas J. Lipton Inc.: real estate; undetermined. Olin Corp.: commingled realty fund; undetermined.

Vanguard Group
Logicon Inc.: money market; portion of $30 million.

Well, Patterson, Hamilton & Allen
Boy Scouts of America; equities; undetermined. City of Tampa (Fla.) General Employees Retirement Fund: equities; $15 million.

Warburg Investment Mgmt. Int'l
Weirton Steel Corp.: international equities; $10 million.

Weiss, Peck & Greer
Los Angeles County Employees' Retirement Association: equities; $80 million.

Wells Fargo Investment Advisors
Rockefeller Foundation: EAFE index; $150 million. Polaroid Corp.: bond index; $10 million.

Wertheim-Philippe Int'l
Oregon Public Employes Retirement System: international; portion of $158 million. Public Employees Retirement Association of Colorado: international; $100 million.

Wilmington Trust Co.
H.F. du Pont Winterthur Museum Inc.: equities; $5.5 million.

Worldinvest Ltd.
Dennison Manufacturing Co.: global balanced; $20 million.

$50 billion

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Investment guidelines for non-qualified trusts are set by state utility commissions and may be more liberal than those of the IRS; for instance, California allows non-qualified trusts to put up to 60% of their assets in equities.

To date, many utilities that have set up trusts have opted for the qualified type, but some have set up both types of trusts because of limits on the amount of tax-deductible contributions to qualified trusts.

Also, because the tax deduction for contributions became law in the 1984 federal tax bill, money set aside before that for decommissioning is not in qualified trusts, said Harry Haynes, principal of William M. Mercer-Meidinger-Hansen Inc., Kansas City, Mo.

The assets of qualified trusts must be invested in certificates of deposit, Treasury and agency securities or municipal bonds.

"There's going to be a lot of money flowing into these trusts over a period of years," said Richard Marsh, director of benefit investments for Ohio Edison Co., Akron, which expects to set up a decommissioning trust later this year.

"There's a lot of interest from the investment community in this," he said.

"It's sort of a sure thing from their point of view."

The managers benefiting most from such trusts may be those with expertise in fixed income and experience with taxable as well as tax-exempt investing. The trusts' profits are taxable at an annual rate of 34%.

This makes municipal bonds an attractive choice, because their coupon income is tax-exempt, although capital gains on such securities are taxable, said Gerry Barth, portfolio manager at Morgan Stanley Asset Management, New York.

At times, however, Treasuries might have better after-tax yields than municipals' tax-free ones, he said.

Mr. Barth said there are 115 nuclear reactors in use in the United States; the decommissioning cost for each one could range from $150 million to $500 million, he said.

This would mean between $17.2 billion and $57.5 billion in decommissioning trusts. Other estimates have put the expected flow into trusts as high as $100 billion.

"It's a difficult number to put your hands on as to what the size will be," he said.

No definitive figures were available on how much already is in trusts, although more than one-third of the nation's utilities have established them.

Money managers might look to decommissioning trusts to replace some of the dollars they haven't been getting from pension funds the past few years, as companies have been able to lower pension fund contributions, Mr. Marsh said.

But they might have to be patient, said Christopher C. Arvani, assistant treasurer-banking at Detroit Edison Co.

"Our fund is a tiny fund — it's not the megabucks Wall Street is looking for," Mr. Arvani said.

Detroit Edison recently set up the decommissioning fund, hiring National Bank of Detroit as trustee and manager. It expects to contribute about $2.5 million a year.

As for funding, the new regulation states internal funding is not acceptable, leaving external as the only viable option, said Scott DuBoss, a partner in the Washington law firm of Bishop, Cooke, Purcell & Reynolds.

"Economists generally agree the internal mechanism is somewhat less costly than external," Mr. DuBoss said.

But the tax advantage of the external method makes up for this, he said.

Until about two years ago, two-thirds of utilities nationwide funded decommissioning trusts internally, Mr. DuBoss said.

That number has been decreasing as more utilities opt for external funding and some states (fewer than 20) require it. ■

Merrill

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Brenda McCoy, an equity analyst at PaineWebber Inc.

"If the bond market continues fairly strong, then I think Salomon will come out on top," she said.

Merrill, ranked third in 1987, had to muscle its way past the biggest players in the bulge bracket to take first place.

"People are obviously feeling pretty good," said Grant Kvalheim, head of capital markets at Merrill Lynch. "We're not managing the business on a quarter-by-quarter basis. The goal is to do it for the whole year."

Merrill Lynch got to the top by "bidding aggressively for corporate debt" and by underwriting large closed-end funds, said Michael W. Blumstein, an equity analyst at First Boston Corp.

Merrill dropped to second in the global underwriting rankings for the first half, swapping places with First Boston/Credit Suisse First Boston, which had ranked second in the first quarter.

Still, Merrill Lynch has much to be pleased about. The firm grabbed the No. 1 spot in the first half in both initial public offerings and total equity offerings, categories in which it had held second and third place, respectively, in the first quarter.

Merrill also has done well in earning healthy fees for its underwriting services, IDD data show. If all credit is given to the book manager, Merrill produced a total gross spread of $314.3 million. Deals managed by Drexel Burnham Lambert Inc. earned a gross spread of $253.9 million, making the biggest underwriter of high-yield bonds the second biggest producer of underwriting fees.

Although IDD data do not show how much of the gross spread each book manager took for itself in a co-managed offering, the figures offer a rough measure of the fees collected by underwriters.

Merrill's deals earned an average total gross spread of $1.786 million while the figure for Drexel is $3.096 million. Drexel's spreads are higher than Merrill's and most other major investment banks because of its prowess in the riskier and more rewarding non-investment-grade business.

Salomon Brothers, the second-ranked investment bank based on domestic underwriting volume, produced an average gross spread of $1.14 million while the deals managed by third-ranked Goldman, Sachs & Co. generated an average gross spread of $607,000.

Among other highlights of first-half underwriting:

- Drexel Burnham emerged from the first half with 46.7% of the high-yield bond business, compared with 41.5% a year earlier. News reports of federal inquiries into Drexel's high-yield operations apparently have had little negative impact on the firm's high-yield business.
- PaineWebber and Prudential-Bache Capital Funding scrambled back into the top 10 in domestic underwriting after finishing 17 and 11, respectively, in the first half of 1987. Kidder, Peabody & Co. and Smith Barney, Harris Upham & Co. dropped out of the top 10.
- Wheat, First Securities Inc. completed the first half with more total underwriting volume than Donaldson, Lufkin & Jenrette Inc. and Dillon, Read & Co. combined. Wheat, First finished the first half of 1988 with an underwriting volume of $2.1 billion. DLJ finished with $835.1 million; Dillon had $1 billion.

Wheat, First — a Richmond, Va.-based securities house — was the only firm from outside New York City to finish in IDD's list of the top 15 domestic underwriters.

- Salomon Brothers, the traditional leader in mortgage-related securities, finished second behind Goldman, Sachs. The positions of the two firms in the mortgage area was reversed in the same period last year. ■

1st half 1988 underwriting rankings
(Full credit to lead manager)

All issues - global*

Firm	Volume $ mils.	Market share (%)
1. First Boston/CSFB** (2)	25,206.8	9.8
2. Merrill Lynch (3)	24,510.3	9.5
3. Salomon (1)	22,195.2	8.6
4. Goldman, Sachs (4)	*21,397.8*	*8.3*
5. Morgan Stanley (5)	16,356.4	6.3
6. Shearson Lehman (6)	12,590.5	4.9
7. Drexel Burnham (8)	10,960.1	4.2
8. Nomura (7)	10,500.2	4.1
9. Deutsche Bank (12)	6,945.5	2.7
10. Daiwa (10)	6,538.2	2.5

* All taxable issues, debt and equity, worldwide
** First Boston/Credit Suisse First Boston
Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (3)	21,760.2	15.1
2. Salomon (1)	20,161.4	14
3. Goldman, Sachs (4)	19,584.9	13.6
4. First Boston (2)	16,103.5	11.2
5. Morgan Stanley (5)	14,346.3	10
6. Shearson Lehman (6)	11,906.2	8.3
7. Drexel Burnham (7)	10,960.1	7.6
8. Prudential-Bache (11)	5,021.1	3.5
9. Bear, Stearns (9)	4,599.9	3.2
10. PaineWebber (17)	4,066.8	2.8

* All taxable issues, debt and equity, sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (5)	15,447.1	17.1
2. Salomon (1)	13,667.1	15.1
3. Goldman, Sachs (2)	10,729.5	11.9
4. First Boston (4)	*10,304.1*	*11.4*
5. Morgan Stanley (3)	9,265.4	10.3
6. Drexel Burnham (7)	8,339.3	9.2
7. Shearson Lehman (6)	7,159.9	7.9
8. Smith Barney (10)	2,452.2	2.7
9. PaineWebber (15)	2,348.3	2.6
10. Wheat, First Securities (11)	2,000	2.2

* All taxable issues, debt and equity, excluding mortgage-related and agency issues sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

All debt issues

Firm	Volume $ mils.	Market share (%)
1. Salomon (1)	19,154.9	15.4
2. Goldman, Sachs (4)	18,279.2	14.7
3. Merrill Lynch (3)	17,923.9	14.4
4. First Boston (2)	15,136.5	12.2
5. Morgan Stanley (5)	13,830.6	11.1
6. Drexel Burnham (6)	9,512.2	7.7
7. Shearson Lehman (7)	8,915.4	7.2
8. Bear, Stearns (9)	4,599.9	3.7
9. Prudential-Bache (10)	3,663.8	2.9
10. Kidder, Peabody (8)	2,905.8	2.3

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Non-investment grade debt

Firm	Volume $ mils.	Market share (%)
1. Drexel Burnham (1)	5,634.7	46.7
2. First Boston (3)	1,672.9	13.9
3. Morgan Stanley (2)	1,392.3	11.5
4. Salomon (5)	615	5.1
5. DLJ (6)	506.3	4.2
6. Smith Barney (10)	498.1	4.1
7. Goldman, Sachs (8)	385.2	3.2
8. Prudential-Bache (NA)	369.9	3.1
9. Merrill Lynch (4)	325	2.7
10. Bear, Stearns (11)	280.6	2.3

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Mortgage-related debt

Firm	Volume $ mils.	Market share (%)
1. Goldman, Sachs (4)	8,595.4	17
2. Salomon (1)	6,494.3	12.8
3. First Boston (2)	5,467.2	10.8
4. Merrill Lynch (3)	5,214.4	10.3
5. Morgan Stanley (7)	4,871.6	9.6
6. Shearson Lehman (5)	4,542.6	9
7. Bear, Stearns (9)	3,655.5	7.2
8. Prudential-Bache (10)	3,120	6.2
9. Drexel Burnham (8)	2,620.8	5.2
10. PaineWebber (21)	1,718.5	3.4

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Initial public offerings

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (1)	2,702	21
2. Shearson Lehman (5)	2,454.3	19.1
3. Wheat, First Securities (2)	2,000	15.6
4. PaineWebber (17)	1,674.6	13
5. Prudential-Bache (11)	1,285	10
6. Salomon (12)	392.3	3.1
7. First Boston (9)	384	3
8. Drexel Burnham (6)	383.5	3
9. Goldman, Sachs (4)	357.4	2.8
10. Alex. Brown & Sons (3)	211.4	1.6

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Common stock

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (3)	3,011.3	18.8
2. Shearson Lehman (2)	2,774.1	17.3
3. Wheat, First Securities (5)	2,000	12.5
4. PaineWebber (16)	1,729.9	10.8
5. Prudential-Bache (15)	1,357.3	8.5
6. Drexel Burnham (6)	1,333.8	8.3
7. Salomon (10)	653	4.1
8. Goldman, Sachs (1)	615.7	3.8
9. First Boston (7)	384	2.4
10. Smith Barney (13)	312	1.9

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Preferred stock

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (2)	825	24.2
2. Goldman, Sachs (4)	690	20.2
3. First Boston (3)	583	17.1
4. Salomon (8)	353.5	10.4
5. Morgan Stanley (1)	275	8.1
6. Shearson Lehman (5)	216.7	6.3
7. Drexel Burnham (7)	114	3.3
8. Oppenheimer (10)	100	2.9
9. DLJ (12)	67.4	2
10. Alex. Brown & Sons (NA)	66.2	1.9

Source: IDD Information Services, New York
Numbers in parentheses show 1st half 1987 rankings

Economists

D. Levine

R. Dederick

R. Rippe

R. Chandross

D. Bostian

Continued from page 3

executive vice president and chief economist for The Northern Trust Co., Chicago, said the chance of a 1988 recession was 50%. Now, the stronger-than-expected first-half showing has him predicting only a 10% chance, "just because something can always happen."

Mr. Dederick had anticipated the October market crash would have had a chilling effect on consumer spending and business investment, but "neither the consumer nor the businessman backed away as much as we thought," he said.

"They acted as if it didn't happen. They dodged from the bullet that we thought would at least hit them."

Economic growth

"Growth has been faster than expected," Mr. Dederick said. In December, he had predicted only a 1% real GNP growth. "The export boom and the capital spending boom gave consumers the wherewithal to increase spending at a faster rate than otherwise we thought they would be able to — and they did it," he said.

John Hekman, senior economist for Claremont Economics Institute, Claremont, Calif., said the strength of business investment was the biggest factor in the stronger-than-expected growth. The institute had predicted a 2.8% growth rate for the first half.

"For us, the most surprising development in 1988 has been the boom in business investment and how that's pulling the economy," Mr. Hekman said.

"We had said investment would help lead the economy, but it boomed more than we expected."

Richard Rippe, senior vice president and economist for Dean Witter Reynolds, New York, said a very strong improvement in net exports stemming from the lower value of the dollar, and a "big year" in capital spending — he said real business growth in the first quarter increased at a 21% annual rate — caused the economy to grow more in late 1987 and the first quarter 1988 than he had expected.

However, Mr. Rippe leans on the low end of his December prediction of a 2.5% to 3% growth for the second half of the year — now he calls for a "2% to 3%" growth for the second half because of the aging of the current business cycle and the possibility of sharp fluctuations in currency exchange rates.

Robert Chandross, vice president and chief economist of Lloyds Bank PLC, New York, said the greater-than-expected demand for credit, the moderately rising inflation rate and the willingness of the Federal Reserve Board to tighten credit should lead to higher interest rates in the second half of 1988.

While in December he had predicted rates of 6.5% and 9.35%, respectively, on 90-day Treasury bills and 30-year Treasury bonds, he is now calling for year-end rates of 7% and 9.75%.

Mr. Levine notes that even with the economy growing moderately stronger than anticipated, it is still not thundering.

"A strong economy does not mean 3% or 4% growth," he said. "Growth is very volatile historically," he said, noting that in 21% of the quarters in the past 35 years the economy grew more than 6%.

Inflation

Inflationary pressures through near-full capacity utilization and a tight labor supply were concerns mentioned by the economists contacted by *P&I Age*.

Mr. Levine said capacity problems and tightening labor markets were two factors leading him to call for a moderate rise in inflation, to 5.1% in the second half. In December, he predicted a 5% inflation rate for the first half, rising to 5.7% in the second half. But because the GNP did not grow during the first half at his predicted 6.7% rate, he revised downward the inflation prediction.

In December, Mr. Dederick had predicted a 4% inflation rate in both halves of the year; Mr. Dederick is now predicting a 4.6% inflation rate in the second half, after an apparent 4.5% rate the first half.

He thinks inflation will pick up, although he notes that could be offset by a continued soft oil market. "At the end of the year (1987), we thought the cyclical and inflation clocks would be set back by the market crash. They weren't," he said.

Although the Farm Belt drought was of concern to many economists, David Bostian of Bostian Research Associates, New York, said he doesn't think a continued Midwest drought would boost inflation.

"The immediate impact of the drought is deflationary rather than inflationary. It takes away from consumer spending elsewhere," he said.

Claremont's Mr. Hekman said he expects continued slow consumer spending — which he said turned down after a strong first quarter — to hold inflation down. The institute is sticking with its 3.5% inflation prediction for the second half of the year.

Deficits

Mr. Hekman said the lower dollar plus productivity gains should level off the trade and budget deficits.

In December, the institute expected the trade deficit in 1988 to be about $150 billion; it now is forecasting only a $135 billion deficit.

Lloyds Bank's Mr. Chandross said stronger growth abroad with the lower value of the dollar, combined with increased revenues from near-full domestic capacity utilization, bodes well for both the trade and federal deficits.

While in December he predicted a 1988 fiscal-year federal deficit of $160 billion, he said he now thinks 1988 will end with about a $155 billion deficit. The 1988 trade imbalance, which in December he had predicted would be $170 billion, is now on a target of $143 billion, he said.

Mr. Bostian said even though the dollar has rallied lately, he expects the trade deficit could even dip below $100 billion because of strong overseas demand and productivity and quality improvements by American manufacturers.

"American manufacturers are incredibly competitive," he said. "They have gotten their acts together."

Some of the economists don't expect the November presidential election to have much effect on action on the deficit.

While Lacy Hunt of Carroll, McEntee & McGinley Inc., New York, said "the big difference between George Bush and Michael Dukakis is that Bush doesn't have any expensive new programs," others thought the deficit would be confronted no matter who won.

"Whoever is elected president knows something will have to be done," said Dean Witter's Mr. Rippe, adding he is almost certain of "significant" budgetary action in 1989. "It is a question more about what we do than whether we do something about it," he said.

Added Mr. Bostian: "No matter who's elected, the deficit should come down." ■

Swiss exchange is off to a good start

By John Parry

ZURICH, Switzerland — A surge of interest by institutional investors got Switzerland's fully automated options and futures exchange off to a flying start last month, despite some technical glitches.

During the first 21 days of trading — May 19 through June 17 — the Swiss Options and Futures Exchange logged 145,170 option deals, a daily average of 6,921, SOFFEX President Ernst Mollet said at a press conference. Mr. Mollet, a vice president of Swiss Bank Corp., one of the exchange's founders, said June 15 was the high mark so far, with 16,731 option deals.

Most deals were on calls rather than puts, which Mr. Mollet said was due to Swiss investors' cautious approach to the new exchange.

"But this is going to change," he said in a later interview. "One of the things that has surprised and pleased us is the way institutional investors moved into the SOFFEX market in the second half of its first month's operations. This shows that we are meeting a need."

SOFFEX, in which the major Swiss banks and the country's three stock exchanges have invested some $50 million in start-up costs, claims to be the world's first fully automated exchange. There is no trading floor, no shouted instructions and no paper — everything is handled from computer terminals in the 52 members' offices. The members now are Swiss-based banks, although foreign banks are expected to join.

The system is so successful, he said, SOFFEX is selling its software to the embryonic West German futures exchange, which hopes to be operational late this year.

"This is a logical development for us," Mr. Mollet said. "The London futures exchange is working with NASDAQ and the Amsterdam exchange with Chicago, so it's logical we would have an international link of our own."

The German link might be strengthened in the future with German stock futures and options contracts being traded on SOFFEX and vice versa, he said.

"There has always been a considerable interest by institutional investors here in German stocks, so why not eventually add them to SOFFEX," he said.

For the moment, SOFFEX trades options in 11 major Swiss securities; in the fall, it will offer options on 24 Swiss stocks. Foreign stocks "are in the pipeline," Mr. Mollet said. ■

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